No. 15,187

IN THE

United States Court of Appeals

For the Ninth Circuit

S. B. HUFFMAN, Trustee in Bankruptcy of Charles Manfre Transportation Co., Bankrupt,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On appeal from the United States District Court for the Northern District of California, Southern Division.

APPELLANT'S OPENING BRIEF.

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STATEMENT AS TO JURISDICTION.

This case was initiated by a Petition for Order requiring asserted lien claimant to propound claim filed November 1, 1955, before the Honorable Bernard J. Abrott, Referee in Bankruptcy (R. 3-5). On the same day an Order to Show Cause was entered and thereafter served upon appellee (R. 5-7). Appellee submitted to the jurisdiction of the bankruptcy court and filed its Response to Petition and to the Order to Show Cause on January 17, 1956 (R. 7-9). A hearing was had before the said referee and on January 26, 1956, a Turnover

Order was entered in favor of appellee (R. 9-12, 20-27). Appellant perfected a timely appeal to the United States District Court for the Northern District of California, Southern Division, by filing a Petition for Review on March 1, 1956 (R. 12-14). Review was had on the Referee's Certificate on Petition to Review Turnover Order before the Honorable O. D. Hamlin, United States District Judge (R. 28). On May 16, 1956, an order affirming the said Turnover Order was entered and filed (R. 18). Appellant filed a timely Notice of Appeal on May 26, 1956 and served a copy thereof on the appellee (R. 19). The jurisdiction of this Court to hear the appeal is founded on Section 47 of Title 11 of the United States Code (11 U.S.C.A. Sec. 47) and on Section 1291 of Title 28, United States Code (28 U.S.C.A. Sec. 1291).

STATEMENT OF THE CASE.

The facts in this case, as established by the verified petition of appellant (R. 3-5), the response of the appellee (R. 7-9), and the oral stipulations between counsel for the respective parties in the hearing before the Honorable Bernard J. Abrott, Referee in Bankruptcy (R. 20-27), are as follows:

Charles Manfre Transportation Co., herein referred to as the "bankrupt," was purchasing four trucks from Utility Trailer Sales. On March 2, 1954, prior to the bankruptcy proceedings herein, Utility Trailer Sales repossessed the four trucks from the bankrupt. On March 9, 1954, appellee served a Notice of Levy on Utility Trailer

Sales demanding payment for $18,457.57 of internal revenue taxes owed to appellee by the bankrupt (R. 3-4). The Notice of Levy is set out in full at R. 22-23.

Utility Trailer Sales failed to make delivery to appellee of the four trucks or of any other property or rights to property belonging to the bankrupt in its possession. After receiving service of the Notice of Levy, Utility Trailer Sales sold the four trucks to other persons, one on April 16, 1954, to George Takahara and I. J. Joseph and the other three to John Freitas Transfer on June 23, 1954 (R. 3-4). There is nothing in the record to indicate that appellee took any action to enforce its Notice of Levy either by proceeding against Utility Trailer Sales for its failure to deliver up possession of the trucks (or other property belonging to the bankrupt) or by proceeding against the transferees of Utility Trailer Sales to enforce its lien, if any, on the trucks.

On June 4, 1954, the bankrupt filed its petition for bankruptcy in the court below and was adjudicated a bankrupt on June 7, 1954 (R. 15). During the process of administering the bankrupt's estate for the benefit of its creditors, appellant became aware of the controversy between the bankrupt and Utility Trailer Sales over the repossession of the bankrupt's trucks. As a result, appellant brought a proceeding against Utility Trailer Sales in the bankruptcy court below and after a hearing before the Referee in Bankruptcy was successful in achieving a compromise of the matter. In settlement of appellant's claim on behalf of the bankrupt, Utility Trailer Sales agreed to pay $2,309.49 into the bankruptcy estate. After approval of the compromise

settlement by the bankruptcy court below on October 24, 1955, the $2,309.49 was paid to appellant (R. 4-5).

Thereafter appellant initiated the present proceeding in bankruptcy by filing its petition for order requiring asserted lien claimant (appellee) to propound its claim to the $2,309.49 received from Utility Trailer Sales (R. 3-5). On January 17, 1956, appellee filed its response setting up its lien for $15,816.37 of income and excise taxes plus penalties and interest for a total of $18,457.57. Appellee also claimed that the sum of $2,309.49 had been reduced to its possession by its service of a notice of levy on Utility Trailer Sales twenty-two months earlier. Appellee therefore demanded that the $2,309.49 not be administered by the bankruptcy court below in accordance with the priorities of the Bankruptcy Act, but that appellant be ordered to turn the money directly over to appellee for application to its claim and lien for taxes. Appellee did not resist or challenge the jurisdiction of the bankruptcy court to dispose of the money (R. 7-9).

The court below entered its order in favor of appellee, and it is the affirmance of this order from which appellant brings this appeal (R. 9-12, 18, 19).

SPECIFICATION OF ERRORS.

1. The court below erred in finding (page 2, line 7, Referee's Findings of Fact adopted by court below) that on March 9, 1954, appellee caused a levy to be made on Utility Trailer Sales Company, whereas in truth and in fact appellee served only a written notice of levy on Utility Trailer Sales Company on that date.

2. The court below erred in finding (page 2, line 17, ibid.) that when the taxpayer was adjudicated a bankrupt June 7, 1954, the obligation of $2,309.49 was paid to appellant, whereas in truth and in fact the said sum was not paid to appellant until October 27, 1955, after hearings upon a petition filed by the Trustee for a Turnover Order, the granting of said petition and the issuance of a Turnover Order.

3. The court below erred in finding (page 2, line 14, ibid.) that the obligation of the Utility Trailer Sales Company at the time said levy was served to the taxpayer was $2,309.49, whereas in truth and in fact no liquidated sum of money was presently owing by Utility Trailer Sales Company to the taxpayer at the time of levy nor was it possible to determine at that time whether any amount would ever become due; the amount and the existence of the obligation of Utility Trailer Sales Company were not determined until October 27, 1955, after hearings upon a petition filed by appellant for a Turnover Order, the granting of said petition and the issuance of a Turnover Order.

4. The court below erred in concluding (line 23, Order of court below dated May 16, 1956) that the levy on or about March 9, 1954, against Utility Trailer Sales Company for property belonging to the taxpayer effected a seizure of the obligation of $2,309.49 and reduced it to the possession of the United States. Said conclusion is erroneous and is contrary to law as the levy was not accompanied by possession as required under Section 67c of the Bankruptcy Act.

5. The court below erred in concluding (line 28, Order of court below, dated May 16, 1956) that when the tax-

payer was adjudicated a bankrupt on June 7, 1954, appellant, appointed as trustee in bankruptcy in the proceeding, acquired no rights to the said sum of $2,309.49 as against appellee. Said conclusion is erroneous and contrary to law, as said sum is subject to a first payment therefrom of the actual and necessary costs and expenses of preserving the estate of the bankrupt subsequent to the filing of the petition in bankruptcy and prior wage claims as provided in Section 67c and Section 64a of the Bankruptcy Act.

STATUTE INVOLVED.

Section 67c of the Bankruptcy Act (11 U.S.C.A. Sec. 107c).

> "Where not enforced by sale before the filing of a petition initiating a proceeding under this title, and except where the estate of the bankrupt is solvent: (1) though valid against the trustee under subdivision (b) of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision (a) of section 104 of this title and such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision (a) of section 104 of this title; and (2) the provisions of subdivision (b) of this section to the contrary notwithstanding, statutory liens created or recognized by

the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property, shall not be valid against the trustee: *Provided, however,* That so much of clause (1) of this subdivision as restricts liens for wages and rent and clause (2) of this subdivision shall not apply in proceedings under chapter 10 of this title, unless an order shall be entered therein directing that bankruptcy be proceeded with, or in proceedings under section 205 of this title. The court may on due notice order so much of any lien in excess of the restricted amount under clause (1) of this subdivision and any lien invalid under clause (2) of this subdivision to be preserved for the benefit of the estate and, in any such event, such lien for the excess and such invalid lien, as the case may be, shall pass to the trustee."

SUMMARY OF ARGUMENT.

The question presented by this appeal may be stated simply: Did the notice of levy served by appellee on Utility Trailer Sales on March 9, 1954 have the effect of taking immediate possession of the sum of $2,309.49 paid over by Utility Trailer Sales to appellant nineteen months later in a compromise settlement after bankruptcy proceedings had been commenced? Only if appellee had and maintained possession of the $2,309.49 prior to and on the date of bankruptcy is it entitled to an order awarding it the sum of money free of the administration of the bankruptcy court. Section 67c of the Bankruptcy Act (11 U.S.C.A. Sec. 107c).

1. Appellee did not have actual possession of anything prior to or at the time of the filing of the petition in bankruptcy. All appellee had done was serve a notice of levy on Utility Trailer Sales. This levy was returned unsatisfied. A notice of levy is nothing more than a demand for payment of any property belonging to the bankrupt in the hands of the person served. It is not self-executing. Unless the government takes supplementary action to enforce an unsuccessful levy, or unless the demand is actually complied with, a notice of levy does not transfer possession to the government. Because appellee failed to acquire actual possession over the obligation prior to bankruptcy, it is not entitled to a turnover order requiring appellant to deliver the compromise settlement of $2,309.49 to it. *Goggin v. Division of Labor Law Enforcement,* (1949) 336 U.S. 118, 69 S.Ct. 469.

2. Assuming *arguendo* that a notice of levy may transfer possession of intangible property in some cases, a notice of levy could not have that effect in this case because the obligation owed by Utility Trailer Sales to the bankrupt was uncertain and unfixed at the time notice of levy was served. The existence of any liability to the bankrupt was then contingent and the amount was then unaccrued. Utility Trailer Sales in fact resisted the payment of any amount on this liability against both appellee and appellant. The only intangible property reached by a notice of levy under Section 3710, I.R.C. 1939, is a liquidated obligation definite in amount and fixed in liability. *United States v. Metropolitan Life Insurance Co.,* (CA 2, 1942) 130 F. 2d 149.

3. Assuming *arguendo* that appellee once had possession of the obligation owed to the bankrupt through the medium of its service of a notice of levy, appellee relinquished that possession prior to the bankruptcy action. The obligor had resisted payment of the obligation to both appellee and appellant. Appellee did nothing when its levy was ignored; appellant pursued his remedies to recover payment of the $2,309.49 for the benefit of the bankruptcy estate. Appellee did not object when appellant asserted dominion over the obligation and reduced it to the possession of the bankruptcy court. *Henkin v. United States,* (CA 2, 1956) 229 F. 2d 895. Nor did appellee take any action to preserve its rights by stipulation or otherwise. Its action herein was tantamount to a relinquishment of any right to possession it may once have obtained. *Goggin v. Division of Labor Law Enforcement,* (1949) 336 U.S. 118, 69 S.Ct. 469.

4. By its express terms, Section 67c of the Bankruptcy Act (11 U.S.C.A., Sec. 107c) distinguishes between a "levy" on property and "possession" of the property. One clause of that subsection permits a lien on personal property to be perfected if "accompanied by possession" *or* if accompanied by a "levy". Because Congress expressly differentiated between "levy" and "possession" in one part of the subsection, it cannot be held that "levy" means the same as "possession" in another part *of the same subsection.* Hence any claim that appellee's "levy" was tantamount to "possession" must fail for the reason that such a construction of the statute is contrary to the manifest intention of Congress.

ARGUMENT.

I. A STATUTORY LIENHOLDER MUST HAVE ACTUAL POSSESSION OF PERSONAL PROPERTY IN ORDER TO CLAIM IMMUNITY FROM THE SUBORDINATION CLAUSE OF SECTION 67c OF THE BANKRUPTCY ACT.

A. Introduction.

The statement of points set out in the Transcript of Record herein (R. 30-32) presents several facets of one underlying problem, i.e., the effect of service of a notice of levy upon an obligor of a delinquent taxpayer. This basic problem is not one that is susceptible of easy solution nor is it one that can be resolved by a superficial analysis of existing precedent. It presents a difficult question of statutory analysis and construction that must be faced with all of the factors of conflicting policy kept firmly in mind. And the adjudication of the problem presented by this case on appeal is one that will have far-reaching effects. What is decided here will govern not only this case but also the practices to be followed in many areas in which the bankruptcy law is administered. The precedent set here will decide not only the relations between the Internal Revenue Service of the United States and the bankruptcy court, but it will also affect the conduct of wage earners, of trade creditors and of others who supply the sinews of finance to private business in our economic system. These collateral effects must not be minimized; their importance far outweighs the settlement of this particular legal controversy now on appeal to this Court.

This controversy is one of first impression in this Court. It is not, however, new to the lower federal courts in this Circuit. In the case of *In re Milo O. Frank,* (S.D.

Cal., 1955) 55-2 U.S.T.C. ¶ 9772,[1] the court held for the trustee in bankruptcy against appellee on the same contentions as it is making herein. In the present case, the court below reached the opposite conclusion.

B. What Is a Notice of Levy?

In the present case, the District Director of Internal Revenue served a Notice of Levy upon Utility Trailer Sales Company of San Francisco on March 9, 1954, demanding payment of $18,457.57 of taxes owed by Charles Manfre Transportation Co. A copy of the Notice of Levy, U. S. Treasury Department Form 668-A, is set out on pages 22-23 of the Transcript of Record. The Notice of Levy stated that

> ". . . all property, rights to property, moneys, credits and/or bank reposits now in your possession and belonging to the aforesaid taxpayer and all sums of money owing from you to the said taxpayer are hereby seized and levied upon for the payment of the aforesaid tax, together with penalties and interest, and demand is hereby made upon you for the amount necessary to satisfy the liability set forth above from the amount now owing from you to the said taxpayer, or for such lesser sum as you may be indebted to him . . ."

Basically a notice of levy is nothing more than a notice of tax due and a demand for payment over. It is a request that the person then in possession of property belonging to the delinquent taxpayer turn it over to the government. A notice of levy can result in the transfer

[1]Not officially reported, but bearing the number 59,574-P.T., In Bankruptcy in the Federal District Court for the Southern District of California.

of possession of the property to the government, but only if the person having dominion and control over the property actually complies with the notice. In itself, a notice of levy accomplishes nothing save to place the party holding the property on notice of the government's demand.

This analysis of the language on the face of the notice of levy form is consistent with the statutes empowering the Director to make levies on third parties. Section 3710(a), I.R.C. 1939[2] provides that

> "And person in possession of property, or rights to property, subject to distraint, upon which a levy has been made, shall, upon demand by the collector or deputy collector making such levy, surrender such property or rights to such collector or deputy, unless such property or right is, at the time of such demand, subject to an attachment or execution under any judicial process."

The statute authorizing levies implicitly recognizes the possibility that the third party so in possession of property may refuse or fail to surrender possession of the property as demanded under a notice of levy. It therefore provides a penalty for such refusal or failure. Thus in Section 3710(b), I.R.C. 1939,

> "Any person who fails or refuses to so surrender any of such property or rights shall be liable in his own person and estate to the United States in a sum equal to the value of the *property or rights not so surrendered . . .*" (Emphasis added.)

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[2]Although this levy was served in 1954, its effect must be judged under the 1939 Code. The equivalent section (Section 6332) of the 1954 Code did not become effective until January 1, 1955. Section 7851(a)(6)(B), I.R.C. 1954.

Obviously, if the notice of levy itself gave the government possession of the property or rights (as asserted on the face of the notice of levy form, supra), Section 3710(b) would be meaningless. No cause of action could accrue if service of the levy notice alone placed the government in possession of the property; Section 3710(b) becomes operative only in the case of a person who fails to surrender the property to the government as demanded. If the law presumed a surrender to the government by the mere service of the notice of levy, the government could not be heard to complain that its notice was disobeyed and that possession was not delivered up.

Consequently, we must conclude that Section 3710 itself contemplates the possibility that the property will be retained in the possession of the third party. That is why the Director is given a remedy under subsection (b). Nor is a personal action under Section 3710(b) the Director's only remedy. The Code provides him with another alternative to use against a recalcitrant person who refuses to deliver up property on demand under Section 3710. For example, the Director is empowered to file an action on behalf of the government to foreclose its lien upon the property itself. Section 3678, I.R.C. 1939.[3]

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[3] "In any case where there has been a refusal or neglect to pay any tax, and it has become necessary to seize and sell property and rights to property, whether real or personal, to satisfy the same, whether distraint proceedings have been commenced or not, the Attorney General at the request of the Commissioner may direct a civil action to be filed, in a district court of the United States, to enforce the lien of the United States for tax upon any property and rights to property, whether real or personal, or to subject any such property and rights to property owned by the delinquent, or in which he has any right, title,

In summary, a notice of levy is nothing but a demand for possession. *Givan v. Cripe,* (CA 7, 1951) 187 F. 2d 225, 228; *United States v. O'Dell,* (CA 6, 1947) 160 F. 2d 304, 307. A notice of levy is not a self-executing instrument; of itself, a notice of levy merely creates a cause of action in favor of the United States. Section 3710(a), (b), I.R.C. 1939. In order to obtain possession of the property or rights, either the person holding it must surrender possession to the government or the government must commence a proceeding *in rem* against the property or rights to property or *in personam* against the person who failed to deliver the property.

C. Requirement of Possession under Section 67c of the Bankruptcy Act.

In the administration of estates in bankruptcy, lien claimants are generally entitled to a preferred position as to the assets on which they have a lien. For example, a mortgagee of real property is entitled to have his mortgage satisfied out of the property before any equity is turned over to the bankruptcy court for administration. But lienors claiming liens against personal property must meet a further test before they are entitled to take the liened property free of bankruptcy administration; in the case of a taxing agency, such as appellee, the lienor must show that it had acquired possession of the personal property subject to the lien. If its lien were not reinforced by possession of the property, Section 67c of the Bankruptcy Act (11 U.S.C.A. Sec. 107c) would require the taxing agency, including appellee, to take a subordinate posi-

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or interest, to the payment of such tax." (Section 3678(a), I.R.C. 1939.

tion to preferred wage claims and to costs and expenses of administration.[4]

> "Where not enforced by sale before the filing of a petition initiating a proceeding under this title . . . statutory liens, including *liens for taxes* or debts *owing to the United States* or to any State or any subdivision thereof, *on personal property not accompanied by possession* of such property . . . *shall be postponed in payment* to the debts specified in clauses (1)[5] and (2)[6] of subdivision (a) of Section 104 of this title." (Emphasis added) Section 67c of the Bankruptcy Act, 11 U.S.C.A. Sec. 107c.

Was appellee's lien "accompanied by possession" of the intangible property held by Utility Trailer Sales? Certainly what appellee did in the present case does not

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[4]If appellee had sold the personal property here in question or had made collection prior to bankruptcy, it would also have established its right to retain the proceeds outside the administration of the bankruptcy court. Section 67c, supra. This alternative is not in question in the present proceeding, because appellee did not follow up its notice of levy with any further proceedings looking toward a sale of the obligation owing to the bankrupt-taxpayer.

[5]Clause (1) debts are "the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition," including "the reasonable costs and expenses of (recovering) for the benefit of the estate of the bankrupt . . . property of the bankrupt, transferred or concealed by him either before or after the filing of the petition . . ." Section 64a(1) of the Bankruptcy Act (11 U.S.C.A. Sec. 104a(1)).

[6]Clause (2) debts are "wages not exceeding $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt." Section 64a(2) of the Bankruptcy Act (11 U.S.C.A. Sec. 104a (2)). Amended by Act of July 30, 1956, Sec. 1, Public Law 840, 84th Congress, to include "commissions" as well as "wages." The amendment is not material herein.

measure up to the requirements of possession demanded of lien holders in other cases that have arisen under Section 67c of the Bankruptcy Act. For example, in *Goggin v. Division of Labor Law Enforcement,* (1949) 336 U.S. 118, 127, 69 S.Ct. 469, 474, the United States prevailed under Section 67c because it had taken *actual* possession of the bankrupt-taxpayer's personalty prior to the filing of the bankruptcy petition.[7] The same was true in *United States v. Sands,* (CA 2, 1949) 174 F. 2d 384, 386, another case in which the United States prevailed. In the *Sands* case, the Collector had actually seized the personal property of the bankrupt taxpayer and had removed these assets to his office prior to the bankruptcy proceeding. Accordingly, the federal tax lien was "accompanied by possession" within the meaning of Section 67c. To the same effect are *Henkin v. United States,* (CA 2, 1956) 229 F. 2d 895, and *Davis v. City of New York,* (CA 2, 1941) 119 F. 2d 559.

The theory of these decisions, in which the government prevailed, is consistent with both the meaning and the purpose of the statute. By taking actual possession of the taxpayer's personalty, appellee placed everyone who dealt with the taxpayer on notice of its claim of lien against the property. No one, whether wage earners or trade creditors, could be misled by the amount of the taxpayer's property or by the status of the government's claim therein. And this was the purpose for which Sec-

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[7]The facts, as recited by Justice Burton for a unanimous Court, show that the Collector had not only taken actual possession of the personal property, but also had attempted two sales of the property prior to his negotiations with the trustee in bankruptcy. 336 U.S. 118 at 122, 69 S.Ct. 469 at 471.

tion 67c was introduced into the Bankruptcy Act. These provisions were first considered by Congress in 1936. In an explanatory note to the provision that later became Section 67c, it was stated,

> "It is significant that in recent years state legislatures have been enacting special legislation in favor of tax claims, public debts, and a variety of private claims. Statistics in the bankruptcy cases show that the effective administration of the bankruptcy law has seriously suffered therefrom. Such claims, particularly tax liens, often consume the entire estate, leaving nothing for the payment of the costs and expenses of administration incurred in reducing the assets to cash. In many such cases the tax liens represent an accumulation of delinquent items covering a long period of time, without any attempt on the part of tax collectors to enforce payment prior to the bankruptcy proceeding.
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> "There is therefore need for a provision to protect the administration costs and expenses; and similar considerations apply to wage claims. Accordingly we have selected, from among the priorities fixed by Section 64 (as revised), these particular items for protection. However, by reason of the historical development and the inherent differences existing in the incidents attaching to real and personal property, it would seem advisable to restrict the remedy thus provided to liens on personal property, where such liens have not been enforced by sale prior to bankruptcy."[8]

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[8]A discussion of the legislative background of this statute is found in footnote 8 of Justice Burton's opinion in *Goggin v. Division of Labor Law Enforcement,* (1949) 336 U.S. 118, 127, 69 S.Ct. 469, 474. See also Judge Hutcheson's concurring opinion in *City of New Orleans v. Harrell,* (CA 5, 1943) 134 F.2d 399, 401.

After the filing of this report and the above explanatory note, Congress amended the proposed Section 67c to except liens on personal property "accompanied by possession" as well; as those "enforced by sale prior to bankruptcy". This action of Congress in adding the "possession" clause after the bill had been reported "gives it special emphasis", according to Justice Burton, "and suggests its appropriate effect as a warning to other claimants that the property, so possessed, will not be available in the first instance for the administrative expenses and wage claims." *Goggin v. Division of Labor Law Enforcement,* (1949) 336 U.S. 118, 127, note 8, 69 S.Ct. 469, 474.

From this analysis of the legislative history, the Supreme Court concluded that

> "The background of §67, sub. c suggests a conscious purpose to give a narrowly limited priority to administrative expenses and to certain wage claims, at least in instances disclosing accumulations of *unpaid taxes the priority of which wage earners had no good reason to suspect,* and which might absorb the entire estate of the bankrupt unless postponed by these provisions. The purpose of §67 in *requiring a public warning of the existence of an enforceable statutory lien for taxes* was served in the instant case not only by the steps taken to perfect the Government's lien but by the Collector's *seizure and actual possession* of the personal property of the taxpayer before the filing of the taxpayer's petition in bankruptcy." (Emphasis added.) 336 U.S. at 127-129, 69 S.Ct. at 474-475.

But appellee seeks to prevail in the present case by arguing that (1) the service of a notice of levy gave it

"constructive" or "legal" possession, and (2) "constructive" or "legal" possession is the equivalent of actual possession for the purpose of satisfying Section 67c. Whether or not service of a notice of levy gives appellee "constructive" possession (see Part II, infra), it is clear that "constructive" possession would not give the type of public warning demanded by Section 67c.

Under the facts of the present case, appellee took no action to warn creditors and wage earners of its claim to a possessory lien. It made no seizure of assets; it removed no personalty from the taxpayer's premises; nor did it even commence any suit against the holder of the taxpayer's obligation to entitle it to a *lis pendens* on that asset. It did nothing but cause to return unsatisfied a notice of levy served on an officer of Utility Trailer Sales. Certainly the service of a notice of levy upon a third party gives no public notice or warning to the creditors and wage earners of the taxpayer; these parties are kept in ignorance of the government's lien unless the government proceeds against the taxpayer itself. If public warning is the purpose to be served by Section 67c, then the requirements of "possession" cannot be met by obtaining "legal" or "constructive" possession. It was for this reason that the Court of Appeals for the Second Circuit reached different results in its two decisions of *Davis v. City of New York,* (CA 2, 1941) 119 F. 2d 559, and *City of New York v. Hall,* (CA 2, 1944) 139 F. 2d 935. In the *Davis* case, the City of New York prevailed over the trustee in bankruptcy on a tax lien claim by showing that it (1) had docketed a warrant for the delinquent tax with the county clerk, (2) had seized the

bankrupt's property prior to bankruptcy, and (3) had sold the property by tax sale after bankruptcy.

But in the *Hall* decision, the City of New York's lien for taxes was subordinated to claims of administration and wage claimants. All the city had done was to (1) docket the warrants for the delinquent tax with the county clerk, and (2) send two officers out to seize the bankrupt's personal property. These officers completed their seizure by posting notice of sale at 4:30 p.m. However, at 4:22 p.m. on the same day, the petition in bankruptcy was filed. Because the filing of the bankruptcy petition antedated the city's completion of its seizure, the Court of Appeals held for the trustee in bankruptcy. In analyzing the term "possession" as used in Section 67c, Judge Frank observed,

> "The word 'possession' drips with ambiguity. It is not a single purpose word and must be contextually construed. That for some purposes, under some sections of the act, it may include 'constructive possession' gives us no answer to our question. We are convinced that Section 67, sub. c, meant something more. * * * The facts here are illustrative: the City's claims are for taxes which had accumulated for seven or eight years respectively. Notwithstanding the admonition of Section 67, sub. c, the City chose to slumber on its rights. Congress intended to penalize such somnolence.
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> "* * * Whether steps taken pursuant to State 'law' are sufficient to constitute 'possession' under 67, sub. c, is a question of Federal 'law'. *That conduct must adequately warn potential petitioning creditors of the existence of the lien.* The City's action did not satisfy that test." (Emphasis added.)

This conclusion of Judge Frank's has been approved by this Court of Appeals. In *Division of Labor Law Enforcement v. Goggin,* (CA 9, 1947) 165 F. 2d 155, 157,[9] it was stated, "We agree with the Second Circuit in *City of New York v. Hall,* 139 F. 2d 935, in the holding that 'possession' as used in Section 67, sub. c, means actual possession, the purpose being to protect and give warning to creditors."[10]

D. Conclusion.

Certainly there is no inequity in rigorously applying Section 67c to appellee in the present case. Had appellee obtained actual possession of the bankrupt's property, or had the property been sold by appellee, appellee might equitably claim to be entitled to the entire amount of the sales proceeds free of the claims of the trustee for expenses of administration and of wage earners for wages earned immediately prior to bankruptcy. But here, where ap-

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[9]Reversed in *Goggin v. Division of Labor Law Enforcement,* (1949) 336 U.S. 118, 69 S.Ct. 469, on another ground relating to the effect of a stipulation between the parties. In effect, the Supreme Court's stand on the requirement of actual possession paralleled that of this Court.

[10]The admonition of Section 67c to lienors that they must take actual possession prior to bankruptcy becomes the more important in view of this Court's later decision in *United States v. England,* (CA 9, 1955) 226 F.2d 205. There it was held that a federal tax lien is enforceable in bankrupty against the trustee although it had not been filed for public record. We do not quarrel with this result, but we do point out that such a lien is completely secret and hidden from public scrutiny. Consequently it becomes all the more incumbent upon appellee, as the potential holder of such liens, to interfere publicly with the taxpayer's possession so that actual warning may be given to all those interested in his estate. And service of a notice on a third party, without action against the taxpayer, would not afford that all important public notice.

pellee did nothing to enforce its notice of levy, the same equity in its favor is not present. All of the costs and effort of reducing the property to possession and of converting the obligation of Utility Trailer Sales into cash were borne and made by the appellant.

This balancing of the equities between the parties was a factor in the adoption of Section 67c as part of the Bankruptcy Act in 1938. As it is pointed out in 4 *COLLIER ON BANKRUPTCY* (14th ed., 1942, Matthew Bender & Co.), § 67.27(1),

> "The general rule that lienors should not have to bear the costs and expenses of a bankruptcy proceeding, which are the first items to be paid under §64a, has usually, however, been subject to the limited exception that where the lienor has invoked the aid of the bankruptcy court in enforcing his lien or where the bankruptcy court properly sells the property free of liens, the lienor is chargeable with his share of the direct and necessary expenses of preserving and realizing the security."

Certainly no one, especially the lienor whose claim is paid in part or in full, could equitably attack this principle. He has had the benefit of the trustee's services and should pay for them. Section 67c, for the policy reasons discussed above, goes beyond the limits of this equitable principle to subordinate certain statutory liens on personal property to "provide a measure of much-needed protection, (1) for administrative costs and expenses in the interest of bankruptcy administration, and (2) for wage claims in the interest of protecting a weak but deserving economic class, against the ravages of certain accumulated liens on the bankrupt's property." COLLIER, *op. cit.*

But in the present case, appellee seeks the benefit of appellant's effort and expenses in liquidating the bankrupt's claim against Utility Trailer Sales and also demands payment over of the *full* amount of the fund so created (R. 9). This is not proper. Appellee would be entitled to the fund only if it had been the party to liquidate the claim and to reduce the fund to possession. In that event appellee properly could have challenged the jurisdiction of the bankruptcy court (which it did not and could not do here) over the fund and could have retained the fund for application in full to its tax liens. *Henkin v. United States,* (CA 2, 1956) 229 F. 2d 895, 897; *In re Brokol Manufacturing Co.,* (CA 3, 1955) 221 F. 2d 640, 642. Here, however, appellee had to rely upon the services of appellant, the trustee, and upon the jurisdiction of the bankruptcy court over the fund in order to obtain anything for application to its lien claim. Had appellant not pursued Utility Trailer Sales to force a settlement payment of the bankrupt's claim, no fund would have been created against which appellee might later assert possessory rights. Section 67c was written for the purpose of penalizing inaction such as appellee's herein; administration of bankruptcy estates will be encouraged and strengthened only by awarding the avails to the party which actually enforces the bankrupt's inchoate rights.

II. SERVICE OF A NOTICE OF LEVY UPON AN OBLIGOR UNDER A CONTINGENT OBLIGATION NOT YET FIXED OR DETERMINATE IN AMOUNT IS INEFFECTIVE TO REACH THAT OBLIGATION.

When appellee served its notice of levy, the sum of $2,309.49 was not in existence; no fund representing the $2,309.49 came into existence until nineteen months[11] later when that sum was agreed to be paid over to appellant in settlement of the bankrupt's claim against Utility Trailer Sales. All that existed prior to the date of the compromise settlement was a right to recovery against Utility Trailer Sales for its action in repossessing the four trucks. This right could not be measured in money terms; the amount Utility Trailer Sales might be liable for was unfixed and indeterminate. No account had been stated between Utility Trailer Sales and the bankrupt. The claim, if any, had not been liquidated. As a matter of fact, at the time the levy was served (March 9, 1954), the trucks seized from the bankrupt still remained in the possession of Utility Trailer Sales. Until the trucks had been sold, no obligation pertaining to them could have accrued in favor of the bankrupt.

Whether a claim even existed against Utility Trailer Sales after the repossession was disputed. Utility Trailer Sales admitted liability neither to appellee nor to the bankrupt. A proceeding and a hearing before the referee in bankruptcy were required before Utility Trailer Sales agreed to pay anything even by way of settlement. Obviously, at the time the levy was served on it, any claim

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[11]The precise time interval between the date of the service of levy (March 9, 1954) and the date of the compromise settlement (October 24, 1955) was one year, seven months, and fifteen days (R. 4-5).

of the bankrupt against it was wholly speculative and contingent.

The levy procedure authorized by the Internal Revenue Code is not designed for cases of this sort. If the person being served has any defenses, or if any contingencies in payment may arise, the levy procedure offers him no opportunity to present these defenses. Hence the courts have held a levy by the Director to be unenforceable against contingent or unliquidated obligations.

For example, a levy by the United States upon a life insurance company to reach the cash surrender value of a policy owned by the taxpayer has been held unenforceable. *United States v. Metropolitan Life Insurance Co.,* (CA 2, 1942) 130 F. 2d 149; *United States v. Penn Mutual Life Insurance Co.,* (CA 3, 1942) 130 F. 2d 495; *United States v. Massachusetts Mutual Life Insurance Co.,* (CA 1, 1942) 127 F. 2d 880. The reasons underlying these decisions are twofold: (1) the levy procedure does not afford any opportunity for beneficiaries, assignees, and other parties who claim an interest in the policy to be heard; and (2) even in a situation in which the taxpayer is the exclusive owner, the policy itself must be surrendered by him before any fixed and determined obligation to pay over arises. In other words, the court's reluctance to countenance the use of the levy procedure against insurers is based upon their concern for the rights of others that may be injured if the United States relies solely upon its levy procedure for collection.[12] But these

[12]Congress was well aware of this limitation upon the use of the levy when it drafted the 1954 Code. It expanded Section 3710, I.R.C. 1939, to include the parenthetical phrase "or ob-

decisions do not mean the United States is remediless if the taxpayer's assets are life insurance equities. Its remedy is to enforce collection of the surrender values of the policy by bringing a suit to enforce or foreclose its tax lien upon the policy under Section 3678, I.R.C. 1939. Because the interests of all the parties—the insured, the insurer, the beneficiaries and any assignees—will be protected and represented in such an action, the courts have readily approved such suits while denying the government the right to proceed by levy. *Schwartz v. United States,* (CA 4, 1951) 191 F. 2d 618, 620; *United States v. Prudential Insurance Co.,* (E.D. Pa., 1944) 54 F. Supp. 664; *United States v. Trout,* (S.D. Cal., 1942) 46 F. Supp. 484.[13]

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ligated with respect to" property or rights to property subject to levy. Section 6332(a), I.R.C. 1954. But in broadening the language of these distraint sections, the Senate Finance Committee stated, "This section (defining property exempt from levy) is not intended to make any change with respect to the status of life insurance policies insofar as levy thereon is concerned." (Sen. Rep. No. 1622 (83d Cong., 2d Sess., 1954), p. 578. See also H. Rep. No. 1337 (83d Cong., 2d Sess., 1954), p A-409.

[13]Compare this analysis with the discussion in *United States v. Stock Yards Bank of Louisville,* (CA 6, 1956) 231 F. 2d 628, 631, as follows: "It should be pointed out, however, that distraint is a rough and ready remedy. This short cut form of self-help developed by the common law has been available to the government in pursuit of delinquent taxpayers since the eighteenth century. (citation omitted) Where the value and nature of the taxpayer's rights are not in question, distraint is no doubt a useful tool in the effective enforcement of the Internal Revenue laws. But it is a blunt instrument, ill-adapted to carve out property interests where their nature and extent are unclear.

"There is available to the government an alternative remedy well-designed to resolve the issues in the present case. Under Section 3678 of the Internal Revenue Code of 1939, the United States can bring suit against the bank to enforce a lien on the bonds and name both the taxpayer and his wife co-defend-

The same considerations are present in this case on appeal. At the time of the levy, Utility Trailer Sales admitted no liability. So long as the obligation incurred by Utility Trailer Sales remained indeterminate and uncertain, summary procedure by way of notice of levy was improper. Utility Trailer Sales, the bankrupt, and the trustee in bankruptcy, appellant herein, would be afforded no opportunity to have their rights determined. Consequently, the levy would have been unenforceable had appellee actually attempted to follow it up. Perhaps that was the reason appellee never attempted to enforce the levy.

Appellee's levy was unenforceable for another but related reason. Generally, it has been held that a levy "speaks only as of the date it is served." An amount becoming due and payable to the taxpayer after the date of service of a notice of levy is not reached by the levy. In this event, the United States must serve a second levy to reach the obligations maturing at a later date.

For example, only *accrued* wages or salary of an employee are subject to levy. A levy is not a continuing order that once served reaches wages or salary payments becoming due after the date of service. *United States v. Long Island Drug Co.,* (CA 2, 1940) 115 F. 2d 983, 986; *United States v. Newhard,* (W.D. Pa., 1955) 128 F. Supp. 805, 809; I.T. 1557, II-1 Cum. Bul. 172; Rev. Rul. 55-227, 55-1 Cum. Bul. 551.[14]

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ants. In such a proceeding the extent of the taxpayer's interest in the bonds can be finally adjudicated, and the rights of all the parties fully protected."

[14]Again Congress had this limitation upon the scope and reach of a levy in mind when it enacted the 1954 Code. In Section

Correspondingly, a levy served on a bank reaches only the depositor's account as of the time the notice is served; it does not reach amounts deposited after the date of the levy. *United States v. Guaranty Bank & Trust Co.,* (E.D. N.C., 1944) 56 F. Supp. 470, 472.

The same rule applies in the present case. Certainly appellant, the trustee in bankruptcy, ought not to be required to labor under greater disabilities than those applicable to taxpayers and holders of taxpayer's properties in the absence of bankruptcy proceedings. If the levy would be had invalid and unenforceable absent the bankruptcy proceedings, it certainly ought not to be treated as vesting "possession" in appellee for the purpose of determining the priority of appellee's lien in a bankruptcy proceeding. An invalid levy not actually complied with cannot transfer "possession" of the obligation to appellee, if for no other reason than the fact that the party served is not required to deliver it up to appellee.

To require appellee to meet the same strict rules in bankruptcy proceedings as it must meet out of them will work no hardship on appellee. If the obligation, as in the present case, is contingent and unaccrued prior to bankruptcy, appellee will be able to meet the test of

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6331, I.R.C. 1954, it expressly provided the same limitation upon its new authorization to levy upon wages and salaries of governmental employees. Section 6331(a) reads, in part, as follows: "Levy may be made upon the *accrued* salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia . . ." (Emphasis added.) In explanation of this section, the Senate Finance Committee said, "The provisions as to levy on salaries of Government employees are the same as those applicable for any other delinquent taxpayer." Sen. Rep. No. 1622 (83d Cong., 2d Sess., 1954) p. 577.

Section 67c by doing one of two things: (1) appellee may sell any rights it may have to the obligation at a public sale; or (2) appellee may bring an action to foreclose its lien against the obligation prior to bankruptcy. Neither alternative places an insuperable burden on appellee, but both alternatives are in the spirit of Section 67c which emphasizes the necessity of public notice and warning. If appellee does not take these two steps, but relies on any lesser procedure as in this appeal, its claim of lien should be subordinated under Section 67c.

III. FAILURE TO ENFORCE A LEVY AND FAILURE TO CONTEST THE ASSERTION OF POSSESSION BY THE TRUSTEE IN BANKRUPTCY CONSTITUTE A RELINQUISHMENT OF POSSESSION.

After having its notice of levy on Utility Trailer Sales returned unsatisfied, appellee did nothing. It made no attempt to enforce the notice of levy by the statutory procedure available to it, nor did it undertake to initiate any other of its statutory methods for collecting the obligation owed the bankrupt. Had "possession" of this obligation been deemed to have been transferred to appellee by virtue of its service of a notice of levy upon Utility Trailer Sales, its subsequent conduct is tantamount to a relinquishment of possession.

Under Section 67c of the Bankruptcy Act, appellee must take and hold possession of the personal property under its lien in order to claim the property free of the subordination clauses. The date on which possession is judged is not the date of appellee's seizure; it is the date

on which the petition in bankruptcy is filed. *Goggin v. Division of Labor Law Enforcement,* (1949) 336 U.S. 118, 69 S.Ct. 469. In the *Goggin* case, the United States had obtained actual possesion of the bankrupt's personal property by a seizure prior to bankruptcy. However, after the bankruptcy proceeding had commenced, the United States, under a stipulation preserving its rights, released these assets to the possession of the trustee in bankruptcy in order to expedite their sale. The trustee in bankruptcy sold the assets and attempted to subordinate the government's claim of lien to expenses of administration and preferred wage claims. This Court supported the trustee. Because the United States had released the custody of the assets to the bankruptcy court, it had relinquished its claim to a lien on personal property "accompanied by possession". *Division of Labor Law Enforcement v. Goggin,* (CA 9, 1947) 165 F. 2d 155.

It was on this point that the Supreme Court reversed the decision of this Court. All parties conceded that the United States had had actual possession of the bankrupt's chattels at the time of bankruptcy. The government's later relinquishment of possession to the trustee did not affect its rights as a possessory lienor because that relinquishment was pursuant to a stipulation reserving the rights of the parties. The only way the trustee in bankruptcy could obtain dominion over the seized property was by way of a stipulated agreement between himself and the government. Without first obtaining the consent of the government, the trustee would have been unable to take over the property for sale in the bankruptcy proceeding.

Obviously, none of these circumstances exist in the present appeal. Appellee was exercising no dominion or control over the obligation of Utility Trailer Sales at the time the petition in bankruptcy was filed. And subsequently when appellant cited Utility Trailer Sales into the bankruptcy court in a proceeding to determine the nature and extent of the latter's obligation to the bankrupt, appellee did not object. It did not protest the bankruptcy court's jurisdiction to interfere with property in its possession, as it would have done had it had actual possession of the obligation. *In re Brokol Manufacturing Co.,* (CA 3, 1955) 221 F. 2d 640, 642; *Henkin v. United States,* (CA 2, 1956) 229 F. 2d 895; *City and County of Denver v. Warner,* (CA 10, 1948) 169 F. 2d 508.

In both the *Brokol* and the *Henkin* decisions, supra, the United States had seized the assets of the bankrupt prior to bankruptcy. [15]

After the seizure by the government, the trustee in bankruptcy attempted to interfere with the government's possession of the assets by a proceeding in the bankruptcy court. To this proceeding the United States objected, claiming the bankruptcy court lacked jurisdiction to determine the validity of its possession. On appeal, this plea to the jurisdiction made by the United States was sustained on the authority of *Cline v. Kaplan,* (1944) 323

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[15]Included among the assets in the *Brokol* case were the bankrupt's accounts receivable; these intangible assets had been reduced to the government's possession by an actual seizure of the accounts receivable books from the bankrupt, followed by notice to the account debtors to pay to the United States. *In re Brokol Manufacturing Co.,* (D.C. N.J., 1953) 109 F.Supp. 562, 564, aff'd (CA 3, 1955) 221 F. 2d 640.

U.S. 97, 65 S.Ct. 155. *In re Brokol Manufacturing Co.,* supra; *Henkin v. United States,* supra.

In the present appeal, appellee made no objection to the jurisdiction of the bankruptcy court;[16] undoubtedly appellee found it impossible to question the jurisdiction of the bankruptcy court because appellee had taken actual possession of the obligation by receiving the settlement payment from Utility Trailer Sales. The only way appellee could assert any right to this payment was to come into the bankruptcy court and plead its rights.

By filing its response in which it invoked the assistance of the bankruptcy court, appellee necessarily recognized the possession of the bankruptcy court, through appellant, over the money. Appellee had played no part whatsoever in obtaining this sum of money; hence there was no need to obtain its consent to administer the settlement fund, as in the *Goggin* case, supra. No stipulation preserving appellee's rights to possession was entered into because appellee itself had long before voluntarily relinquished any rights it might have had. Appellee not only lacked possession of the money but also lacked the benefit of having an agreement preserving its rights. If the *Goggin* case was correctly decided, the present case must go the other way. In *Goggin* it was necessary for the trustee to first deal with the United States in order to obtain the

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[16]Appellee's response to appellant's original order to show cause raised three points: (1) that appellee's claim for taxes had become a lien against the bankrupt's property; (2) that because appellee's lien was "accompanied by possession", appellant had no interest in the obligation of Utility Trailer Sales; and (3) that the bankruptcy court lacked jurisdiction to determine whether or not Utility Trailer Sales was liable to appellee under Section 3710, I.R.C. 1939, for "noncompliance with the levy" (R. 7-9).

property for administration; in the present case, appellee's inaction and failure to enforce its levy permitted appellant to obtain the property for administration in the bankruptcy estate.

IV. SERVICE OF A NOTICE OF LEVY UPON AN OBLIGOR DOES NOT REDUCE THE OBLIGATION TO POSSESSION OF THE UNITED STATES WITHIN MEANING OF SECTION 67c OF THE BANKRUPTCY ACT.

A. Introduction.

The fact that clause (1) of Section 67c speaks in terms of "possession" does not confine its application to tangible personal property.[17] *In re Milo O. Frank,* (S.D. Cal., 1955) 55-2 U.S.T.C. ¶ 9772. And compare *In re Brokol Manufacturing Co.,* (D.C. N.J., 1953) 109 F.Supp. 562, aff'd (CA 3, 1955) 221 F. 2d 640. Obviously many types of intangible property are just as susceptible of being "possessed" as tangible property. In the *Brokol Manufacturing Co.* case, for example, the government had seized the bankrupt's accounts receivable and was making collection of the accounts from the bankrupt's debtors. Compare also the procedure followed by the Collector in *In re Mutual Carrier Co., Inc.,* (D.C. Conn., 1952) 52-2 U.S.T.C. ¶ 9507. There accounts receivable of the bank-

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[17]Whether the Fourth Circuit intended to so limit Section 67c in *United States v. Eiland,* (CA 4, 1955) 223 U.S. 118, 123, is not clear from the language used in the opinion. The Court said, in reference to Section 67c, "That section also manifestly has reference to tangible property which can be taken into possession, not to indebtedness which has been levied upon with notice to the debtor so that it is to all intents and purposes assigned to the United States." Further on, the Court states, "If the statute be construed to apply to indebtedness . . ."

rupt were taken into possession by an actual seizure of the books of the account, followed by a notice to the trade debtor to pay the seized accounts to the Collector.

Many other types of intangible property can be reduced to actual possession. Stock certificates, bonds, all types of negotiable instruments and all other obligations which are evidenced by a document or by a writing[18] are all capable of being possessed within the meaning of Section 67c. In such cases, in which the intangible is reduced to a writing, it would be improper for the government to attempt to obtain any rights over the property by merely levying upon the obligor without also seizing the evidence of the intangible as well.[19]

Certainly in the case of evidence of indebtedness and other documentary intangible property, Section 67c can be enforced according to its literal terms to require the government to take actual possession of the property prior to bankruptcy. Where the government does anything less, its lien should be subordinated. For example,

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[18]Section 3690. I.R.C. 1939, which authorizes the Collector to proceed by distraint against a delinquent taxpayer, specifically enumerates a number of classes of intangible property. The Collector is authorized to collect the delinquent taxes by distraint and sale "of the goods, chattels, or effects, *including stocks, securities, bank accounts, and evidences of debt,* of the person delinquent as aforesaid." (Emphasis added.)

[19]If the Collector failed to seize the documentary evidence itself, the taxpayer holder of a "security" would have the power to divest the government of its lien thereon by transferring the security to a purchaser, pledgee or mortgagee who takes his interest for value without actual notice or knowledge of the lien. (Section 3672(b)(1), I.R.C. 1939. "Security" is defined for this purpose as including "any bond, debenture, note or certificate, or other evidence of indebtedness, issue by any corporation . . . negotiable instrument; or money." Section 3672 (b)(2), I.R.C. (1939).

in *In re Milo O. Frank,* (S.D. Cal., 1955) 55-2 U.S.T.C. ¶ 9772, the government had a lien on shares of stock owned by the bankrupt. But all it did prior to bankruptcy was serve a notice of levy upon a bailee of the stock certificates. For the lack of an actual seizure prior to bankruptcy, the lien of the government was subordinated under Section 67c.

And this interpretation is in accord with sound policy. To eliminate intangible personal property from the reach of Section 67c would be to place such property on a par with real property. Real property was specifically eliminated from the subordination clauses by Congress for the reason that creditors and others do not rely upon the facts of possession as demonstrating ownership. Record title is what counts. Hence there is no need to require that a statutory lien on real property be accompanied by possession in order to give adequate warning to creditors and wage earners.

But record title plays even less importance in the case of intangible personal property than in the case of tangibles. If possession is to be required of tangible personalty, certainly the equivalent, or more, is to be required of intangibles. Any other conclusion would require a trustee to distribute tangible personalty to one set of claimants and intangibles to another without any distinction being drawn in the statute for such differences in treatment. Furthermore, if the term "personal property" in Section 67c does not include intangibles, then Section 70f of the Bankruptcy Act (11 U.S.C.A. Sec. 110(f)), which is *in pari materia,* would not authorize the trustee in bankruptcy to sell intangible property because

it authorizes the sale of only "real and personal property". Naturally no such distinction has been drawn under Section 70f. See 4 *COLLIER ON BANKRUPTCY* pp. 1556-1558; Feigenbaum, J. Walter, "The Bankruptcy Triangle: Creditor-Debtor-Commissioner," *TAXES, THE TAX MAGAZINE,* June, 1952 issue, 448 at 453, note 25.[20]

Consequently, we must assume that all the Court of Appeals of the Fourth Circuit meant to hold in *United States v. Eiland,* supra, was that in its opinion the "possession" requirement of Section 67c was met by the government's action in that case. We do not believe the *Eiland* conclusion is applicable to the present case for the reasons discussed below.

B. "Possession" of an Obligation.

Under the mandate of Section 67c, appellee must take possession of the liened personal property if it wishes to hold the property free of bankruptcy administration. The fact that appellee may encounter difficulty in reducing the property to possession, because of its intangible nature, does not excuse appellee from meeting the requirements of the statute. To water down the statutory requirement of "possession" in the case of intangible property, as appellee has argued below, is to destroy the very

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[20]Any other conclusion would make clause (1) of Section 67c inconsistent with clause (2) of the same section. Clause (2) applies to liens on "personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property." Obviously Congress intended to subject liens on intangible personal property to the subordination provisions of clause (2) because it expressly added the execution processes of levy, distraint and sequestration which are capable of being applied to intangible as well as tangible personal property.

purpose of the statute. Possession by a taxing agency, including appellee, must be so open and notorious that public warning is given to all who deal with the bankrupt. Any concept of "possession" which leaves the property or the obligation in the hands of the bankrupt or in the hands of third parties is not sufficient to carry out the legislative purpose of providing public notice and warning. For this reason the courts have said that "actual possession" is necessary to meet the test of Section 67c. *Goggin v. Division of Labor Law Enforcement,* (1949) 336 U.S. 118, 69 S.Ct. 469; *United States v. Sands,* (CA 2, 1949) 174 F. 2d 384, 386. "Constructive" or "legal" possession is not sufficient to satisfy Section 67c. *City of New York v. Hall,* (CA 2, 1944) 139 F. 2d 935; *Division of Labor Law Enforcement v. Goggin,* (CA 9, 1947) 165 F. 2d 155, 157, rev'd on other grounds, (1949) 336 U.S. 118, 69 S.Ct. 469.

In *United States v. Eiland,* (CA 4, 1955) 223 F. 2d 118, the Fourth Circuit took the opposite approach. There appellee had served a levy upon a coal company for taxes owed by the bankrupt. The coal company owed the bankrupt $1,885.54 at the time the levy was served. Three days after service of the levy, the bankrupt filed its petition in bankruptcy. On these facts, the Fourth Circuit held that appellee had taken possession of the indebtedness under its lien for taxes and was entitled to have the entire indebtedness, up to the amount of the levy, paid to it free of claims of administration and wage claims. In other words, appellee's lien on the indebtedness was "accompanied by possession" within the meaning of Section 67c of the Bankruptcy Act.

This decision, we believe, is wrong. But whether it is wrong or not, it does not govern the present case. In *Eiland,* the levy was proper; it was made upon a presently liquidated and accrued obligation. In the present appeal, the levy was improper; it was ineffectual to reach a contingent, unliquidated and unaccrued obligation owed to the bankrupt. As we pointed out above in Part II hereof, a levy is not the proper remedy for appellee to use in asserting any rights it may have against a contingent claim. In order to protect the interests of the third party debtor and to assure that his defenses to the claim of liability are heard, appellee must proceed by suit to foreclose its lien or to enforce its notice of levy. Certainly the debtor should not be required to pay until it is found that he actually owes the taxpayer some money.[21]

Another important difference between *Eiland* and the present appeal is found in the time that elapsed between the service of the levy and the filing of bankruptcy. In *Eiland,* it was but three days; in the present appeal, it was three months (March 9, 1954 to June 4, 1954, R. 4-5). At first blush this may appear to be an unimportant distinction. But the decision in *Eiland* rests in part upon the shortness of this time interval. "The United States had done everything that it could to assert dominion over the indebtedness . . ." 223 F. 2d 118 at 123. Certainly the same statement could not be made in the present case. Here appellee slept on its rights during the three-month period prior to bankruptcy. It made no attempt

[21]Until it is determined or conceded that the third party debtor is actually in debt to the taxpayer, no action will lie under Section 3710, I.R.C. 1939 to enforce the levy. *United States v. Metropolitan Life Insurance Co.,* (CA 2, 1942) 130 F. 2d 149.

to enforce its levy by filing suit under Section 3710, I.R.C. 1939. Nor did it attempt to foreclose its lien on the contingent liability as authorized under Section 3678, I.R.C. 1939. Because of the much greater interval of time between the service of levy and the filing of bankruptcy in the present case, it would be unreasonable not to require appellee to take these further steps in order "to assert dominion" over the bankrupt's contingent claim.

C. A Levy as "Possession" under Section 67c.

Independently of these other considerations, a mere notice of levy cannot, as a matter of accurate statutory construction, be the equivalent of "possession" as required by Section 67c of the Bankruptcy Act. If *Eiland v. United States,* (CA 4, 1955) 223 F. 2d 118, meant to hold to the contrary, it is wrong.

The reason for making this flat assertion lies in the language of Section 67c itself. That subsection of the Bankruptcy Act provides for the subordination of three classes of liens on the personal property of the bankrupt. The first class, found in clause (1) of the subsection, covers all statutory liens, including tax liens of the United States or of the states.[22] The second class, also found in clause (1), comprises liens of distress for rent, whether statutory or not.[23] The third class, found in

[22]The precise statutory language is as follows: "statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property . . ."

[23]"liens, whether statutory or not, of distress for rent . . ."

clause (2) of Section 67c, consists of statutory liens fo debts owing to private persons and others.[24]

Each of these three classes of liens is subordinated un der Section 67c. Clause (1) liens (statutory liens fo governmental obligations and liens of distress for rent are expressly postponed in payment to costs of adminis tration and wage claims. Clause (2) liens (private statu tory liens) are more than postponed in payment; they are invalidated in full as against the trustee in bank ruptcy.

Because clause (2) liens are treated much more harshly in bankruptcy than clause (1) liens, the circumstances under which Section 67c comes into play are much more rigorous under clause (2) than under clause (1). In other words, a clause (2) lienor is provided with several alterna tive methods under which he may perfect his statutory lien to protect it against the harsher invalidation pro visions of Section 67c. A private statutory lienor under clause (2) may protect his lien on personal property by taking action under any one of the following four alterna tives prior to bankruptcy:

(1) Accompany his lien by possession

(2) Levy upon the property

(3) Sequester the property

(4) Distrain the property[25]

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[24]"statutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property . . ."

[25]The precise statutory language is as follows: "statutory liens . . . on personal property *not accompanied by possession of, or by levy upon or by sequestration or distraint* of such property, shall not be valid against the trustee . . ." (Emphasis added.)

Clearly Congress could not have intended to equate "possession" with "levy", because it spoke of them as different things. If the concept of possession could be met by a mere levy, the insertion of the phrase "by levy upon" in clause (2) of Section 67c would be mere surplusage. "Levy upon" is expressly made an alternative test to "accompanied by possession".[26] Implicitly then "levy upon" must mean something different than "accompanied by possession".

The final conclusion follows necessarily from this preliminary conclusion. If "levy upon" is a concept different from "accompanied by possession" in clause (2) of Section 67c, it must be a different concept than "accompanied by possession" in clause (1) of the same section.[27] Any other conclusion inescapably implies that Congress did not know what it was doing when it chose the two forms of expression and used them in the same statute.

The *Eiland* opinion did not deal with or even discuss this problem of statutory construction. Clause (2) and its bearing on the interpretation of clause (1) were ignored by the Fourth Circuit. Undoubtedly the point was not called to that court's attention as it was reaching its decision. The point not having been considered by the court, its decision cannot be accepted as authoritative precedent.

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[26]The two requirements are coupled together by the disjunctive connective "or".

[27]The two clauses are not only found in the same subsection of the Bankruptcy Act but they deal with similar problems, i.e., the recognition of statutory liens on personal property in proceedings under the Bankruptcy Act. Clearly the phrases "accompanied by possession" are *in pari materia* and must be construed alike in the two clauses.

Certainly the *Eiland* case should not be read as interpreting the phrase "accompanied by possession" as meaning "levy upon".[28]

On the basis of the statutory language itself, appellee's mere levy made on Utility Trailer Sales in the present case cannot be the equivalent of reducing its lien to "possession". Being the holder of a lien on personal property unaccompanied by possession, appellee's claim must be subordinated to costs of administration and preferred wage claims. For this reason, the order appealed from must be reversed.

D. Effect of a Reversal Herein on Bankruptcy Administration.

In *Eiland v. United States,* (CA 4, 1955) 223 F. 2d 118, the Fourth Circuit indicated great concern for the problem the government faced in attempting to reduce intangible property to "possession" prior to bankruptcy in order to prevent the subordination of its lien on personal property. In manifesting its concern, it made what appears from the published opinion to be a faulty construction of the statute.[29] Its reasoning appeared to be the following:

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[28]What, if any, steps the United States took in addition to its levy upon the obligation of the bankrupt's debtor does not appear from the reported opinions of either the district court or the Court of Appeals in the *Eiland* case.

[29]Whether or not the United States took any additional steps to reduce its lien to possession, such as making an actual seizure of the account receivable from the bankrupt, does not appear. Compare, for example, the procedure followed by the Collector in *In re Mutual Carrier Co.,* (D.C. Conn., 1952) 52-2 U.S.T.C. ¶ 9507. There the Collector (1) seized the books and records of the bankrupt prior to bankruptcy; (2) notified the account debtors of this seizure; and (3) directed the debtors to make payment of the accounts directly to the Collector.

(1) The United States must reduce its lien to possession.

(2) The United States had served a levy.

(3) Because it is difficult to comprehend taking possession of an intangible obligation, the levy must be equated with taking possession in order to prevent the tax lien from being subordinated.

It is the third step of this syllogism with which we quarrel. Under Section 67c, a lien on personal property is entitled to protection under two circumstances: (1) the liened property is actually sold and the proceeds are in the hands of the lienor, or (2) the lien is accompanied by possession. Not all intangible property is unsusceptible to possession, as, for example, stock certificates. But if the particular intangible property is of such a nature that it cannot be readily "possessed", the same cannot be said of its proceeds. Why, then, does it follow that the government is to be excused from the requirement of obtaining possession? Yet that was the conclusion voiced in the *Eiland* case. But it seems equally accurate to conclude that if the property cannot be possessed, then the government can protect its lien by collection on or a sale of the property prior to bankruptcy. Actual sale prior to bankruptcy is an alternative written into the statute itself. Thus, appellee is not reduced to impotency if it is required to meet a strict test of what constitutes "possession" for the purpose of claiming a super-priority for its liens in bankruptcy.

In general, appellee is well protected in a bankruptcy proceeding. If its claim for taxes is unsecured by a lien,

appellee is not relegated to the status of a genera creditor. Rather, appellee is entitled to a preferred posi tion under Section 64a(4) of the Bankruptcy Act. 1 U.S.C.A. Sec. 104a(4). Its claim for taxes, even whe unsecured, is payable immediately after costs of adminis tration, preferred wage claims and costs of setting asid a discharge; correspondingly, a tax claim is payable ahea of other priority debts, rental claims and dividend to general creditors.

Furthermore, unlike most other creditors, appellee's ta claims are discharged only by payment. A discharge i bankruptcy does not bar claims for taxes not actually paid Yet appellee is favored with special priorities not avail able to claimants who must be paid in the bankruptcy pro ceeding or not at all. Section 17a of the Bankruptcy Act 11 U.S.C.A. Sec. 35a(1).

If appellee has assessed its claim for taxes prior t bankruptcy, it is by virture of the assessment and demand for its payment entitled to the status of a general lien holder. It is not even required to file its lien for record prior to bankruptcy in order to enjoy a lien status as to *all* of the property of the bankrupt in the bankruptcy estate. *United States v. England,* (CA 9, 1955) 226 F. 2d 205. As a claimant holding a lien, appellee is entitled to payment out of the bankruptcy estate prior to all pre ferred charges, including other tax claims. The only ex ception is to be found in the one case of a lien on per sonal property unaccompanied by possession. In this latter case, appellee's lien is subordinated by virtue of Section 67c to costs of administration and preferred wage claims. Its lien, however, would entitle it to priority over all othe

tax claimants not enjoying a similar status. Hence it is difficult to see how appellee's tax collecting ability can seriously be affected by a decision herein favorable to appellant.

On the other hand, the status of bankruptcy administration will be seriously prejudiced if the orders appealed from are affirmed. Generally it is the policy of the courts to encourage a strong and vigorous administration of bankruptcy estates. Trustees in bankruptcy are encouraged to hunt out property and rights of the bankrupt and reduce them to possession for the benefit of the bankrupt's creditors, including appellee. But if recovery by the trustee is to be barred in any case in which he finds a stale notice of levy previously served, the administration of bankruptcy estates will be that much the poorer. And the classes of claimants entitled to public notice and warning under the statute will get neither. Appellee will be empowered to file its claim in bankruptcy and await payment out of the other assets collected by the trustee. Only if these assets are insufficient in amount will appellee be under an incentive to enforce its stale levy on the obligation held out of the bankruptcy estate. Had appellee realized upon the obligation by sale or collection prior to bankruptcy, it would have applied the proceeds to the bankrupt's taxes, reducing its bankruptcy claim pro tanto. But where appellee has not made collection, has not taken possession and has not attempted to enforce its levy, we have another case. Appellee ought not to have the power to freeze assets outside the jurisdiction of the bankruptcy court without being required to enforce its levy and collect or sell the obligation. Section 67c of the Bankruptcy

Act requires appellee to do just this, if it is interprete as it was written.

CONCLUSION.

The order of the court below affirming the turnove order of the Referee in Bankruptcy herein should be re versed and the said orders be set aside with instruction that the lien of appellee herein be subordinated as re quired by Section 67c of the Bankruptcy Act.

Dated, San Francisco, California,
October 10, 1956.

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